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General Business Conditions

THE day-to-day business reports continue to show a mixture of firm and soft spots, which in the aggregate add up to a steady volume of trade and a high level of industrial operations. Markets, however, have been easy. In both merchandise and basic commodities, buyers are shopping for bargains and keeping commitments short. In some degree this caution may be due to fears that a Korean truce will depress prices; or that industrial expansion is being overdone; or that the progressive return of buyers' markets and narrowing profit margins may be a prelude to general recession. But probably the chief reason why buyers are not reaching out is that they are already well stocked, and are now confident that the industrial organization of this country can produce both guns and butter, to meet every need. They have found that scarcity can change quickly to ample supply, as illustrated in many staple commodities and almost all consumers' goods. Hence demand is no longer augmented by inventory accumulation, but has dropped back to current needs, or lower.

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Among the soft spots slackness in household equipment items is pronounced. Purchases of these items were extraordinarily heavy for many months after Korea, they have a long life, and recent buying has not come up to manufacturers' expectations. Except in some of the newer products, stocks are large. Price cuts and factory curtailment have been features of the April news. Nor has there been any substantial improvement in textiles, and textile mills also have cut output further.

Production Holds at Peak

With the overall business figures, however, there can be little dissatisfaction. In the industries the drop in consumers' goods over the past few months has been offset by expansion in industrial equipment and materials and in defense work. The Federal Reserve Board's index of industrial production, at 220 in March (1935-39 = 100), compared with 223 a year earlier, which was the peak of the boom, and with 213 last July. The April figure will be lower, due mainly to loss of steel output. But the heavy industries have huge unfilled orders, ranging from a few weeks' or months' deliveries in miscellaneous lines up to sixteeen months', on the average, for machine tools and much beyond that, of course, for the aviation industry. Employment is "full" and unemployment subnormal in overall terms, despite the soft spots.

Retail trade is often described as slack, which is true in durable goods, but for trade as a whole steady would be a better word. Department store sales in March, with allowance for seasonal factors including the late Easter this year, were exactly the same as in February and in March last year. April has probably held about the same level, although sales in the first two weeks of the month substantially exceeded the corresponding pre-Easter weeks of 1951. Demand for services, including travel, recreation and many others, has never been so large. According to official Washington estimates, consumer expen-

ditures in the first quarter of the year, seasonally adjusted, were at an annual rate of $209 billion, which is better than in other recent quarters and slightly exceeds the previous record high in the first quarter of 1951.

With this volume of business, and renewed emphasis on turnover, retail and wholesale inventories have been considerably reduced. Department store stocks run 12 to 15 per cent below last year. Merchants are finding better values in the markets, and passing them on to consumers. These are the remedies by which slumps in the consumers' goods industries have always worked themselves out, as in 1949. It is remarkable that the present slump has run as long as it has, in view of record-breaking personal incomes and high consumption; but the boom that preceded it, in the first year after Korea, was a stupendous one, in buying, production and prices.

The prospect for the heavy industries has been strengthened lately, by improvement in the building outlook. With more materials available and restrictions liberalized, commercial and public construction will go ahead more vigorously than expected. Housing starts and contract awards have picked up and surveys now indicate that probably a million homes will be started this year, which is well above earlier estimates. The automobile industry is another which is getting more materials and enlarged quotas. Over and above these supports are the immense backlogs of the machinery and equipment industries, and the calculation of the Defense Mobilization Administration that the annual rate of defense expenditures will rise by $14 billion between the first and fourth quarters of this year. In these areas, at least, activity must be expected to increase.

Effects of Wage Increases

For the long run the intervention of the Federal Administration in the steel wage case, discussed hereafter in this Letter, stands as by far the most momentous development of the month. For the short run also the steel situation may have a pronounced influence. If the strike does not last too long, the production loss can be made up later. But steel wages are certain to be raised and prices advanced. Other wage and price increases are likely to follow. Assuming continuation of demand, the effects will be inflationary; and of course higher wage payments will add to potential demand by increasing money purchasing power. The rise of money incomes and the push on costs and prices gives another turn to the inflationary spiral.

On the other hand, the rise in steel wages and costs obviously is to be absorbed in part by the steel companies, which means that their profits will be reduced; and the rise in steel prices, which are costs to the fabricators and users of steel, will either have to be passed on in prices or absorbed out of profits. On the whole there will probably be more absorption than passing on, for even where demand is strong price ceilings operate. The situation in refrigerators and other household items, referred to above, indicates that those particular markets cannot bear price increases; on the contrary, prices are being cut. Higher costs must reduce profits. If wage rates also are to be forced up again in these industries the effects will be compounded. This raises a far-reaching question, namely, will industries whose profit margins are being reduced so severely go ahead with capital expenditures, especially as they seem to have enough capacity now to satisfy needs?

In summary, higher wage rates will have both inflationary and deflationary effects. The balance between them will vary with time and with other economic developments. To the extent that inflationary effects at first predominate, the economic situation is further raised on stilts. In the longer run the effect of the cost-price disparities created, the impact of higher prices on the buying of the many people who will not receive higher incomes, and the discouragement to enterprise and production, may prove to be the graver consequence.

The Steel Seizure

President Truman's order directing the Secretary of Commerce to "take possession" of the steel industry has been recognized throughout the country as raising constitutional and economic questions so far-reaching that the evolution of American society and the American economic system may be profoundly affected, and conceivably diverted from its historic course, by the outcome. Many people are so deeply conscious of the gravity of the issues, involving judicial determination of the President's powers and the purposes for which they may be employed, that they see the country at a crossroads. From this point it may turn either toward, or away from, a degree of state intervention in economic life that historically has been alien to American principles; and toward, or away from, impairment of rights which every American historically has been deemed to possess.

Probably President Truman would reject such grave views of the possibilities. He has based his action on his belief that an "emergency"

existed, and that he, as the "steward" of the general welfare, should assume drastic powers to deal with it. He would doubtless point to his intention to end the seizure as soon as continuance of steel operations is assured, and would repudiate any idea that his action is a step on a road the end of which would be a totalitarian economy. He stands on the principle that the authority of the Government is superior to any private authority.

Public comment, however, makes it clear that people are not reassured. They are looking beyond the maintenance of steel operations and thinking in terms of rights and freedoms, the limits of executive power, and questions of social and economic organization which go far deeper than the steel case itself. The principle that the authority of the Government is superior to private authority of course is basic in an orderly society, but it is none the less incumbent on the Government to exercise its authority constitutionally and through the democratic process.

The Constitutional Issue

In the first test of the constitutional issue Judge Pine of the U.S. District Court in Washington has found that the President possessed no power to order the seizure, and the Court has therefore issued an injunction restraining the Secretary of Commerce from acting under the order. As this Letter goes to press the Government is appealing from Judge Pine's ruling. If the President persists in his course the ultimate decision, upon which so much rests, of course will be made by the Supreme Court.

The constitutional issue is easy to define. It is whether the President has exceeded the powers conferred upon him by the Constitution or has violated constitutional prohibitions. He cited no authority for the seizure except that vested in him, as President and commander-in-chief of the armed forces, by the Constitution and laws of the country. Thus he relied on inherent or implied powers derived from Article II of the Constitution, which provides for his office and sets forth his duties. Judge Pine held that the Article gave him no such powers by which seizure could be authorized. The judge ruled that the power to provide for the general welfare was lodged in Congress, not the President; and that the President could exercise no power which could not reasonably be traced to some specific grant.

If Judge Pine had found that the President possessed certain inherent powers, it is still inconceivable that they should run against the Fifth Amendment, which states that "No person shall . . . be deprived of life, liberty or property without due process of law." The issue then would have been whether the President, in the absence of specific legislative authorization, could seize property without violating the "due process" clause. Under the constitutional doctrine of the separation of powers, each of the three independent branches of the Government – legislative, executive and judicial – is equal and coordinate. Each has its defined function and is without power to assume the function of another. The executive cannot legislate nor can the legislative branch execute the laws. The very absence of empowering legislation might be construed as establishing that "due process" was not observed.

If the inherent powers could be stretched as far as the Government claimed before Judge Pine, there would seem to be no limitation on the power of a President to suppress free speech and all the other freedoms incorporated in the Bill of Rights, whenever in his own judgment the existence of an emergency or his concept of the general welfare justified it. Moreover, if the power were upheld when used for one group – the unions – against another – the employers – as in this action, it could be used at some other time and by some other person against unions and for employers. The stake of both in the principles involved is in the long run equal, and it is shared by every other American.

The Taft-Hartley Act

Judge Pine in his decision also pointed out that the President's action presupposed that the Taft-Hartley Act "is inadequate when it has not yet been tried, and is the statute provided by Congress to meet just such an emergency." The President could have acted under this law, but was unwilling to do so. Under it he is authorized to appoint a board of inquiry to study and report, and to petition a district court to enjoin a strike. At the end of sixty days the board reports the status of the dispute, and within the next fifteen days the National Labor Relations Board conducts a secret ballot of the employes to determine whether they want to accept the final offer of the employer. If the strike is not then settled, the Act requires the President to submit to Congress a full report of the proceedings, together with such recommendation as he may make for consideration and appropriate action *by Congress.* This recognizes the paramount character of the national interest and the government authority, but enforces the latter through the democratic and constitutional

process, as the elected representatives of the people may determine.

The President has argued that the length of these procedures would make them unfair to the unions, since the dispute has been under way since last November. However, there has been no showing of valid reasons why the Taft-Hartley Act could not have been invoked near the beginning of the dispute, for example, when the unions' first strike threat was uttered, or when it was referred to the Wage Stabilization Board.

The Economic Issues

While the courts deal with the constitutional question, the economic and social implications of the President's action are no less far-reaching. The country should consider how this crisis developed, the lessons to be drawn, and the portents for the future.

The course of the steel dispute has followed that of many others before it. In long perspective, it is the result of a history of government intervention in labor disputes, which has steadily reduced the effectiveness of collective bargaining processes below the government level, and hence has led to more government intervention. Why this should be so has become clear through experience. When both parties know that a government agency will make the final decision, they are unlikely to make many concessions for the sake of agreement. Wage changes come to be based not on economic considerations, which is what employers and workers have before them when they sit down together, but on political considerations. An aggressive labor leader's goal shifts from what should be granted with due regard for economic factors to what he can induce the Government to give through regard for political factors. The most ambitious and ruthless leader sets the pace, and others must follow to maintain their position and prestige.

To this worker-Government bargaining the union leader brings an immense power because he can now shut down a whole industry. Although industry-wide bargaining has found many supporters among students of labor relations, it has made more frequent government intervention inevitable. A strike against one employer would be unlikely to cripple the nation or greatly affect the general welfare. But in the case of essential industries a union leader can now paralyze the country, and thus create an "emergency" in which the Government finds that force, penalties or seizure are required to preserve the necessary activities of everyday life.

In many significant cases government intervention has substituted worker-Government bargaining for worker-employer bargaining. It has left the employer the Hobson's choice of ratifying voluntarily the terms the Government makes with or recommends for the workers, or of having the terms put into effect by force or seizure.

These are not fanciful statements, for they are borne out by history. It is only necessary to point to the repeated successes achieved by Mr. Lewis and the coal miners by refusing to bargain, waiting for government intervention, and emerging with a little more than any other union leader had yet obtained. The personal intervention of President Roosevelt on behalf of railway unions in 1941 and 1943 may be recalled; he obtained for them greater increases than the boards provided under the Railway Labor Act had recommended. In 1946 and thereafter the Truman Administration dictated patterns for wage settlements, in major industries, which went the rounds, and which by reason of their inflationary effects have proved costly for the country.

Controls Mean Compulsion

Any type of government intervention in economic activity may end in the use of force. Whether the Government undertakes to set the terms of wage contracts or the prices at which sales are made, it must exercise control in order to see that the terms are observed. This introduces the element of compulsion into the economy. When the controls are established by law under democratic and constitutional procedures, it is the common duty to accept and support them and the duty of the executive to enforce them. But one control leads to another. Once the principle of free bargaining and free markets is given up and the principle of compulsion adopted, the areas in which compulsion may be required widen. Since more and more executive decisions are required, it becomes necessary for the Congress to give more and more specific power to the executive; and the temptation of the executive to assume more power increases. Rule of men encroaches on rule of law. The exercise of power in one place requires it to be exercised elsewhere.

This is the history of interventionism everywhere. Many have seen little significance or danger to constitutional liberties in the steps which this country has taken along the interventionist path. Warnings where the road might lead have been belittled and derided, on the ground that they were "reactionary" or grossly exaggerated. But over a long period the country has witnessed the extension of the interventionist process on an increasing scale, made easier, of

course, by war. Now a point has been reached where the doctrine of intervention has been extended by executive action to the point where it has come into collision with the basic democratic concept of the limitation of executive power, and with the Bill of Rights. The dangers seen by those who uttered the warnings of the past must now seem less remote.

In the summer of 1946 the President proposed the passing of a "work-or-fight" law to force railroad workers to continue at work. The power of the Government was to be used against labor. Today the power is being used in reality, if not so stated, to enforce the demands of a labor union. If this power should be allowed to develop without limitation, it might be used in the years to come against any of us — laborers, farmers, stockholders, newspaper readers. All would be subject to executive control in emergencies defined and proclaimed by the same executive.

There is reason to be thankful that the issue has now been raised so clearly.

Arithmetic of Steel Wage Controversy

In the welter of figures that have come out regarding wages, costs, and profits in the steel industry, it has been hard for the average person desirous of keeping an open mind to avoid being hopelessly befuddled. Not only is the statistical array formidable and confusing, but individual items are being constantly challenged. Moreover, much of the data is based on calculations so complex, and involving so many variables, that even the accountants have difficulty getting exact answers.

For these reasons some effort at simplifying the "arithmetic" seems necessary. What are the basic facts in this controversy that the layman can keep in mind? We suggest that they boil down to three main questions:

1. How well off is the steel worker compared with workers in other industries?

2. How has the steel worker fared in keeping pace with wage increases in other industries, and with the rise in the cost of living?

3. What about steel industry profits and the ability, or inability, of the industry to absorb cost increases without raising prices?

Wages in Steel and Other Industries

On the first question, we submit the following table setting forth average hourly earnings in selected industries for the fourth quarter of 1951, as reported by the United States Bureau of Labor Statistics.

Average Hourly Earnings in Selected Major Industries
Fourth Quarter, 1951

Mining —bituminous	$2.236
Contract construction	2.211
Petroleum refining	2.096
Tires and inner tubes	2.017
Automobiles	1.960
Railroad equipment	1.890
BLAST FURNACES, STEEL WORKS, ROLLING MILLS	1.887
Shipbuilding	1.838
Aircraft and parts	1.817
Machinery (except electrical)	1.802
Railway wages (average, class I)	1,776
Electrical machinery	1.652
ALL MANUFACTURING	1.626
Wholesale trade	1.609
Stone, clay, glass products	1.587
Local railways and bus lines	1.583
Paper and allied products	1.548
Food and kindred products	1.499
Lumber and wood products (except furniture)	1.491
Furniture and fixtures	1.430
Textile mill products	1.333
Road building wages, common labor	1.33
Retail trade	1.260
Tobacco manufactures	1.166
Laundries	0.921

It will be seen that the steel workers, with average pay of $1.887 an hour, stood in the upper crust among American workers. Their average was 16 per cent greater than that for all manufacturing industries. Of the 264 categories of production workers and non-supervisory employees whose hourly earnings are reported by the Government, steel workers' earnings exceed those of workers in 218 categories.

Everyone should want to see wages advance, providing the advances reflect genuine increases in productivity and are not merely at the expense of other groups in the community, including other wage earners and also those groups which have provided the capital — in the form of constantly improving tools and equipment wherein lies the real basis of industrial progress. In terms of income, the steel workers are far better off than most of their fellow workers in American industry. They should be among the last to press for advantages at the expense of other American workers and the public at large.

Following or Leading the Procession?

On the question whether the steel worker is lagging behind or heading the procession of wage advances, the union takes the position that he is lagging behind. Said Otis Brubaker, research director of the United Steel Workers, to a special panel of the Wage Stabilization Board in February, "It should be remembered that the steel workers got no wage increase in 1951. The great economic injustice of 1951 was the fact that of all the major industrial groups only the steel worker received no wage improvement."

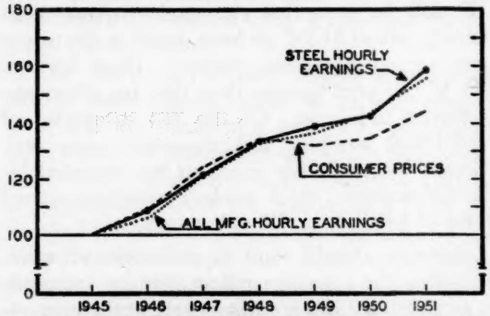
President Truman goes along completely with this union position. How completely is indicated by the following quotation from his April 8 speech to the nation announcing his order for Government seizure of the steel industry:

There has been a lot of propaganda to the effect that the recommendations of the wage board were too high, that they would touch off a new round of wage increases, and that a new wage-price spiral would set in.

The facts are to the contrary. When you look into the matter you find that the wage board's recommendations were fair and reasonable. They were entirely consistent with what has been allowed in other industries over the past eighteen months . . .

Under these recommendations, the steel worker would simply be catching up with what workers in other major industries are already receiving.

To help appraise these statements, we give in the accompanying diagram a comparison on an annual basis for the postwar period, using average hourly earnings as reported by the U. S. Bureau of Labor Statistics, along with the cost of living index computed by the same authority.



Indexes of annual average hourly wage earnings in the basic steel industry and in all manufacturing, and of consumer prices. 1945=100.

From 1945 to 1948 wages in steel and in total manufacturing went up fairly closely together, and about in step with the rise in the cost of living. Since 1948, not only have dollar wages in steel and in manufacturing generally continued to forge ahead, but — more important — owing to the tapering off in the living cost rise, "real" wages have recorded substantial improvement, not cancelled by the renewed upturn in the cost of living after Korea.

The "great injustice of 1951," referred to by Mr. Brubaker in the quotation cited above, apparently was that the steel workers got their wage increase in December 1950. Its effect during 1951 is shown in the diagram.

Now comes the new wage award amounting to a 26½ cent per hour package once the new rates become fully operative. The reader can judge for himself, from the diagram whether this represents mere "catching up," or whether it means getting out far in front, setting an example that workers in other industries will strive to emulate or even improve upon.

Question of Steel Profits

Labor leaders contend that steel profits are exorbitant — ample to absorb the wage increases proposed without raising steel prices or depriving steel industry shareholders of a fair return on investment.

Again Mr. Truman takes the same line. In his speech to the nation, the President said:

Steel industry profits are now running at the rate of about $2,500,000,000 a year. The steel companies are now making a profit of about $19.50 on every ton of steel they produce. On top of that, they can get a price increase of close to $3 a ton under the Capehart amendment to the price control law. They don't need this, but we are going to have to give it to them, because the law requires it.

Now add this to the $19.50 a ton they are already making and you have profits of better than $22 a ton.

Calculating the cost of the recommended wage increase at $4 to $5 a ton, the President said that the steel industry would still be making profits of $17 or $18 a ton, even if they "absorbed every penny of the wage increase." Declaring such profits for steel to be "extremely high," he went on to state:

During 1947, 1948 and 1949, the three years before the Korean outbreak, steel profits averaged a little better than $11 a ton. The companies could absorb this wage increase entirely out of profits, and still be making much higher profits than they made in the three prosperous years before Korea.

The plain fact is — though most people don't realize it — the steel industry has never been so profitable as it is today — at least not since the "profiteering" days of World War I.

A Glaring Omission

In making these statements, however, the President was guilty of a glaring omission. He neglected to tell the American people that the figures he was talking about were earnings *before taxes.*

In 1951 federal income taxes alone took away practically two-thirds of the steel industry's so-called "profits". As Clarence R. Randall, president of the Inland Steel Company, said in his radio rejoinder to Mr. Truman, "Steel companies cannot pay wages and taxes with the same dollars. Nor can the steel industry build new plants when the country calls for steel with the dollars it pays the Government in taxes."

The fact is that in terms of net profit — what the company has left after all costs are paid — the steel industry last year made, not the $19.50 a ton Mr. Truman talked about, but only about a third as much or in the neighborhood of $6.50. And, as Mr. Randall said, that was off 15 per cent from the preceding year.

When Mr. Truman calls "extremely high" the $17 or $18 a ton profit he says the steel companies would be making after the recommended wage increase, and compares these figures with $11 a ton before Korea, he is still talking in

terms of profits *before* taxes. If comparison is made in terms of net *after* taxes, it is seen that a $11 a ton profit in 1947-49 would be equivalent, after federal income taxes then current of 38 per cent, to $6.82 a ton, whereas a $17 or $18 a ton profit today, after a federal tax slice now averaging two-thirds, would be equivalent to around $6.00.

In still another way Mr. Truman's figures appear unrealistic and subject to challenge. In calculating the cost of the recommended wage increase at $4 to $5 a ton, he is evidently figuring only the direct labor cost, without allowance for the probability of such wage increases spreading to other industries and being reflected in higher costs of materials the steel industry itself has to buy. The President states that "a big boost in steel prices would raise the prices of other things all up and down the line." Sooner or later, he says, "prices of all the products that use steel would go up – tanks and trucks and buildings, automobiles and vacuum cleaners and refrigerators, right on down to canned goods and egg beaters." Yet apparently he assumes that an increase in steel wages can be insulated from the rest of the economy.

Pre-tax or After-tax Earnings the Right Basis for Price Policy?

The foregoing, of course, raises the question as to what *is* the proper basis for price control policy – earnings before, or earnings after, taxes?

Industry generally takes the position that taxes are just as much part of the cost of doing business as wages and materials, and as such should be allowed for in arriving at any standard for fair prices.

The Government, on the other hand, holds that it is earnings before taxes that should count. Testifying before a Congressional committee last month former Governor of Georgia Ellis Arnall, Director of Price Stabilization, said:

> I want to say emphatically that profits after taxes cannot be used as a basis for price control policy. It would, in effect, alter Congressional tax decisions, and by the same token simple justice would require that personal taxes should be included in measuring changes in living costs and that workers would therefore be entitled to correspondingly larger cost of living adjustments in their pay.

This argument overlooks two important considerations, brought out effectively in letters to the New York Times recently:

(1) Characterizing as "pure sophistry" the contention that use of an after-tax earnings base would "alter Congressional tax decisions," George O. May, retired partner of Price, Waterhouse & Company, reminds the reader (N. Y. Times, April 23) that "Congress did not determine what taxes corporations should pay but only at what rates their taxes should be computed." He states:

> Governor Arnall should be aware, and, if aware, should have stated that federal (and state) regulatory bodies, such as the Federal Power Commission, call for inclusion of income taxes in operating expense accounts, and take them into consideration in determining the rates of charges to be made by the utilities.

A letter by Simon N. Whitney, Professor of Economics at New York University, is equally to the point. Replying to an earlier letter to the Times supporting the Arnall thesis, Professor Whitney writes (N. Y. Times, April 24):

> On the contrary, it is the Wage Stabilization Board which is proposing to "negate tax legislation" by turning much of steel profits before taxes over to the workers, whereas Congress and the President relied on taxation of such profits as government income when planning the year's receipts and expenditures.
>
> The steel industry is actually fighting for the maintenance of tax revenues, the union and O.P.S. against it.

(2) As to the contention about personal taxes, the answer is simple, and was well stated by Mr. May as follows:

> Since Governor Arnall states that he is a stockholder he must know that personal income taxes are paid by stockholders on the share of the corporation's revenues that come to them as dividends, just as they are paid by wage earners on the share of the fruits of industry that accrue to them as wages.

Or, as Professor Whitney puts it, "True, steel workers will pay taxes, but so would stockholders. What the Government counted on was the double tax, of 52-82 per cent on the corporate income plus the tax on dividends."

Concluding his letter, Professor Whitney really goes to the heart of the matter when he says:

> I have been noticing with some amazement the spectacle of the national executive struggling to transfer income from companies to workers, mainly at the expense of the Treasury itself, partly perhaps – if dividends are affected – at the expense of stockholders, but certainly at the expense of money for reinvestment. The result will have to be a slowdown of steel plant expansion or its stimulation through tax reductions or subsidies.

The "Ability to Pay" Argument

It must be recognized that what we are confronted with here is the old "ability to pay" argument. Neither the union nor the Administration is resting its case primarily on cost of living considerations. The argument on that score is, as shown by the diagram on wages and cost of living, too weak. What they are talking about mostly is all the money that business is making.

Actually, the doctrine of setting wages in accordance with "ability to pay" has, despite a cer-

tain plausibility when applied with reasonable restraint, serious weaknesses. As we have pointed out in these columns before, it is against the long run interest of the public and of workers themselves. The unions would not want to apply it consistently and uniformly even now, since it cuts both ways and would lead to wage reductions wherever profits are non-existent or inadequate.

Inasmuch as we discussed this theory at some length in our January 1946 issue, it may be well to recall briefly three main points made at that time. We quote:

> The first pertinent fact is that the theory is one which labor in practice will use only in good times, when profits are large . . . (It is) certain to be scuttled when conditions change. Yet the rates established in the abnormally good years would remain to block cost and price reductions when the poor years come, and when price reductions are called for not primarily to protect the profit margin but to maintain sales, production and employment.
>
> The second error in the ability to pay theory is that if it is literally applied it must result in gross inequalities in wage rates. Under this theory the rates paid by an enterprise of superior efficiency or good fortune on one side of the street might be substantially above those paid by a run-of-the-mine enterprise on the other. . . . This violates labor's own principle of equal pay for equal work. . . .
>
> The third major point is that if every rise in profit is to be turned into a wage increase, which is the ultimate end of adopting the ability to pay principle, there can be no hope of either higher rewards for the producer or lower prices for the consumer. . . . The industries over the years have constantly made technological gains through better methods and the investment of capital in better equipment. These gains have been roughly divided, through the operation of free competitive markets, between the consumer, the worker and the owners of the business. . . . This is the familiar story of the growth of industries since the industrial revolution took place. . . .

Such long-term social progress, however, cannot go forward if the gains accruing from technological advance are monopolized by any one group.

First Quarter Corporate Earnings

Corporate reports for the first quarter issued during the past month show in most cases substantial decreases in net earnings from those of the first quarter of 1951, when the post-Korean business boom was in full swing. Our tabulation of the statements published to date by 515 companies, mainly larger organizations in manufacturing, mining, trade, and services, shows a combined net income of approximately $1,216 million after taxes, a decrease of 13 per cent from the first quarter of 1951. About seven out of every ten reporting companies had decreases.

Earnings in the first quarter of this year were also 14 per cent below the fourth quarter of 1951, but slightly above the third quarter, as may be seen from the following totals:

Net Income After Taxes of 515 Leading Corporations
(In Millions of Dollars)

	1950	1951	1952
First quarter	$1,189	$1,393	$1,216
Second quarter	1,476	1,391	
Third quarter	1,617	1,153	
Fourth quarter	1,605	1,419	

Total dollar sales this year of manufacturing companies thus far reporting are only 1 per cent above a year ago, despite the effect of higher prices in swelling dollar values; and the number of individual companies having sales increases this year was slightly less than the number having decreases.

A continuing rise in many elements of operating costs, and an inability where sales declined to retrench on expenses proportionately, squeezed gross profit margins so that the balance before taxes was cut 12 per cent. This is shown by the following summary, partly estimated on the basis of companies (a majority of those reporting) which issue sales figures also:

Sales and Net Income of 449 Manufacturing Corporations in the First Quarter
(In Millions of Dollars)

	1951	1952	Change Amount	Change %
Receipts from sales, etc.	$17,573	$17,718	+145	+ 1
Total costs, except taxes	14,211	14,751	+540	+ 4
Balance before taxes	3,362	2,967	—395	—12
Fed. income & e.p. taxes	2,034	1,804	—230	—11
Net income after taxes	1,328	1,163	—165	—12
Taxes to balance before taxes	60%	61%		
Net income per sales dollar	7.6c	6.6c		

As a result of this decline in operating earnings, the liability for federal income and excess profits taxes was reduced 11 per cent, with seven out of every ten reporting companies showing a decrease in their reserve for taxes payable. Such taxes took 61 per cent of operating earnings this year, on an average, against 60 per cent in the first quarter of last year. Present rates are 52 per cent for the normal tax and surtax (an increase from 47 per cent last year having applied to only three-fourths of that year's income) plus 30 per cent excess profits tax on that portion of earnings defined as "excess" relative to a base period. For comparative purposes, many companies have issued revised figures for the first quarter of 1951, to adjust for the retroactive increase in income tax rates later in the year. Others, when they originally issued their first quarter 1951 statements, had already made allowance for an estimated tax increase. A number of companies, which in the first quarter of 1951 set aside substantial tax reserves against earnings, this year incurred operating deficits and therefore their statements

NET INCOME OF LEADING CORPORATIONS FOR THE FIRST QUARTER
(In Thousands of Dollars)

No. of Cos.	Industry Groups	Reported Net Income After Taxes: First Qr. 1951	Reported Net Income After Taxes: Fourth Qr. 1951	Reported Net Income After Taxes: First Qr. 1952	Per Cent Change From: First Qr. 1951	Per Cent Change From: Fourth Qr. 1951
30	Food products	$ 32,010	$ 30,125	$ 22,867	—29	—24
10	Beverages	29,151	21,766	10,188	—65	—53
8	Tobacco products	15,551	15,569	13,912	—11	—11
30	Textiles and apparel	26,604	9,421	10,400	—61	+10
22	Paper and allied products	32,399	20,132	22,544	—30	+12
35	Chemical products	158,588	148,968	133,243	—16	—11
15	Drugs, soap, cosmetics	35,510	27,148	26,186	—26	— 4
27	Petroleum producing and refining	372,874	442,653	409,599	+10	— 7
26	Cement, glass and stone	49,446	39,474	36,398	—26	— 8
28	Iron and steel	137,377	138,203	108,050	—21	—22
15	Building, heating, plumbing equipment	15,628	14,648	7,600	—51	—48
18	Electrical equipment, radio and television	65,484	88,409	54,321	—17	—39
38	Machinery	29,252	33,863	29,273	+—	—14
8	Office equipment	16,562	16,376	15,017	— 9	— 8
11	Automobiles and trucks	156,059	139,595	136,735	—12	— 2
24	Automobile parts	29,402	27,559	25,896	—12	— 6
11	Railway equipment	11,019	16,663	13,927	+26	—16
56	Other metal products	79,034	75,145	61,765	—22	—18
37	Miscellaneous manufacturing	36,353	30,307	25,102	—31	—17
449	Total manufacturing	1,328,303	1,336,024	1,163,023	—12	—13
24	Mining and quarrying*	25,941	35,681	26,308	+ 1	—26
24	Trade (retail and wholesale)	27,949	33,264	15,302	—45	—54
18	Service and amusement industries	10,937	13,642	11,052	+ 1	—19
515	Total	$1,393,130	$1,418,611	$1,215,685	—13	—14

* Net income is reported before depletion charges in some cases.

show no federal tax liability, but instead credits for refunds from the Treasury of prior years' taxes to which they are entitled by law.

After taxes, net income of the manufacturing companies declined by 12 per cent from the first quarter of a year ago. This represents a narrowing of the average net profit margin on sales from 7.6 cents to 6.6 cents per sales dollar.

Fectors in Lower Earnings

The accompanying summary of the quarterly net income by major industry groups shows the generally downward but highly uneven trends which developed this year.

The table shows that there were some exceptions to the drop in net, the most notable of which was petroleum producing and refining, showing a 10 per cent increase. Excluding this important group, the income of the other reporting companies declined 21 per cent.

One major factor in the lower earnings in many lines this year is the curtailment in volume of sales, due variously to shortages of raw materials and government restrictions, to dealers holding down their purchases in order to reduce inventories, or to a shrinkage in consumer demand. The drop in volume has been considerable in such industries as textile products, automobiles and parts, heating and plumbing equipment, and cement, glass and stone building materials. Because of present high "break-even points", even a moderate recession in gross revenues may cause a sharp drop in net income.

In the electrical equipment and household appliance industries, the tremendous postwar production has gone far toward saturating markets, ending the era of easy selling, transforming scarcities to surpluses, and bringing a return to keen competition. In these and other groups, however, there were extremely uneven changes among the individual companies not revealed by the group totals.

The other major factor in lower earnings this year is the pressure of rising expenses against OPS ceilings on selling prices. Many companies whose sales have held up well nevertheless find themselves squeezed by rising costs for materials and supplies, wages, social security and pensions, transportation, state and local taxes, etc. They find that more aggressive advertising and selling effort, and perhaps price-cutting as well, are needed to keep goods moving in volume. Such conditions are referred to frequently in the reports of companies engaged in staple lines — foods, beverages, tobacco products, paper, chemicals, drugs, and cosmetics. In the steel industry, which with a greatly expanded plant established a new high record in output this year, the first quarter reports of 28 companies show that dollar sales increased 4 per cent over the first quarter of 1951, but net income fell 21 per cent.

Special factors also tended to depress earnings in many instances. A continuing shift by some companies from ordinary civilian goods to military products tends to yield lower margins of profit — through the processes of voluntary price redetermination and of contract renegotiation. Charges for depreciation have necessarily been stepped up sharply for those companies which since the war have made heavy capital outlays for the expansion and modernization of

plant and equipment. Where capital outlays and accumulations of inventory have been financed by increases in current or long-term indebtedness, the interest and amortization thereon have added to the burden upon income and cash.

Government Bond Upswing

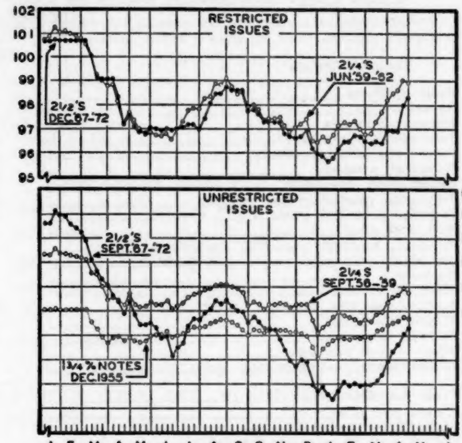
Government bond prices, after selling off to new lows for the postwar period at the close of 1951, have been rising strongly, particularly during March and April. In a swing of sentiment, a bullish atmosphere pervades the market, replacing the caution prevalent around the year end.

The principal basis for buoyancy in bond prices appears to be the easing of international tensions, the associated spreading-out of the defense program, and the lull in inflation and inflation psychology. It remains to be seen whether the market is appraising these developments correctly or whether the inflationary movement will be resumed.

As the accompanying chart shows, government bond prices have now had four swings – two up and two down – since artificial price pegs were withdrawn in March a year ago. The Federal Reserve Banks bought bonds to soften the original decline – which ran to 4 points on some restricted issues – and assist the market achieve a restabilization in May and June. Since then the Reserve Banks generally have maintained a hands-off policy on longer-term government securities and have allowed free market forces to determine price movements. The July-August rebound carried longer term Treasury bonds up 1 to 2½ points. Influenced by seasonal pressures for funds, and some selling to establish tax losses, a second declining phase set in after Labor Day and carried all issues of fully taxable bonds into new low ground, down as much as 5 points from their old pegged levels. A feature of the recent rise has been the strength of bonds restricted as to bank ownership but closely aproaching the dates when their ownership restrictions lapse. This strength reflects the premiums investors are willing to pay for unrestricted marketability together with some pessimism on bank loan prospects. The June 1959-62 2¼s, which drop their ownership restrictions on June 15, have risen from 96½ to 99.

Influence of Monetary Policy

One factor in the current rise in bond prices was the decision of the Federal Reserve authorities to withhold an increase in their 1¾ per cent discount rate. An advance to 2 per cent was widely regarded as imminent in December and bond prices tended to adjust themselves to that contingency as well as to year-end pressures for



Closing Bid Prices, Selected Government Securities

funds. It has subsequently been disclosed, in the course of the Patman inquiry, that the Treasury-Federal Reserve unpegging agreement had included a stipulation that the 1¾ per cent discount rate would be maintained throughout 1951. In any case the weeks passed without discount rate action and gradually the market became convinced that no rate action would be taken.

In February the Treasury had to have aid from the Federal Reserve Banks to put across a new issue of 5-7 year 2⅜ per cent bonds, in exchange for an issue of 2½ per cent bonds that had been called for payment. Thereafter the tone of the bond market improved, particularly after the critical March 15 tax period passed without the development of another money pinch. The extensive use the Treasury made of direct borrowing from the Federal Reserve Banks in March not only eliminated a money pinch but also led some observers to wonder if official policy was not taking a new turn in the direction of cheap money. This view gained support from the Administration's action dropping State and local government borrowings from the sphere of the Voluntary Credit Restraint program, as well as from relaxations in material controls. These actions have been interpreted as indications that the authorities are fearful of a business slump. However, they also will permit the carrying out of projects which will require bond-financing and thus will add to the demand for credit. State bond issues to pay veterans' bonuses constitute a case in point.

Prospective Credit Demands

Barring further shocks to business confidence, and threats to incentive and resources for capital

expansion, such as are embraced in the steel seizure, present prospects are for another year of heavy credit demands. Bank loans, since March 15 tax borrowings, have been undergoing a seasonal contraction though this drift normally will be reversed from August onward under the influence of crop movements and seasonal trade expansion. Bond flotations seem headed for another big year, and the combined total for corporate, State and municipal new-money borrowings may well rival the totals of $8 billion recorded in 1948 and $7½ billion in 1951. Based on the improved availability of materials, and upward revisions in estimates of units to be constructed, home mortgage financing may require another $6 to $7 billion as it did in 1950 and 1951. Deficit-financing by the Federal Government, coming on top of these and variously estimated at $5 to $10 billion for the balance of 1952, is almost bound to create an overload on the current streams of savings.

The behavior of the money and credit markets during the remainder of the year will be heavily influenced by the willingness of the Federal Reserve authorities to supply additional cash and the means chosen to do so. They have three main options: to reduce bank reserve requirements; to buy government securities in the open market; or to force banks to borrow additional money they need at the Federal Reserve discount rate, now 1¾ per cent. It is not expected that recourse would be taken to a cut in reserve requirements save in the possibility of a business downturn and a considerable rise in unemployment. As between buying government securities in the open market and forcing banks to borrow, the expressed preference of the Federal Reserve authorities is to get away from pegging government security prices and to redevelop the discount rate as a key instrument of policy. This was clearly brought out in the course of the Patman monetary inquiry, reviewed in this Letter a month ago, and it is also apparent from Federal Reserve open market policies as conducted since the unpegging. Over the past year the Federal Reserve Banks have entered the market to buy government securities in substantial quantities only to relieve sharp pressure on the money market or to support Treasury refundings in danger of failure.

New Treasury Financing

One thing that the new rise in government bond prices does is to confirm that there are active desires among many classes of investors for United States government securities. The task of the Treasury in the present situation is to design securities that will encourage and enlarge these desires, and pare down as far as possible the amount of cash the Federal Reserve Banks will have to supply.

The improvement in sentiment thus is an encouraging development to the Treasury, which faces its biggest new-money borrowing task since the war. Congress presently is acting to reduce appropriations and the prospective deficit for the fiscal year ending June 30, 1953. This effort may provide means for debt retirement in the January-June 1953 period of flush tax revenues. But in the July-December 1952 half-year tax revenues will be much smaller and borrowings to take care of cash requirements through the end of this calendar year are rather generally expected to exceed $5 billion and might run as high as $10 billion.

As a prelude to larger operations, the Treasury has already borrowed $800 million, in the four weeks ended May 1, by increased weekly Treasury bill issues. A second and larger step was taken April 29 when the Savings bond program was revamped to spur the lagging sales and to bring in new funds over and above the amount of current redemptions.

The Series E bond has been modified to improve the yields on bonds redeemed prior to maturity and the term has been reduced from 10 years to 9 years and 8 months, increasing the rate of return from 2.9 per cent to 3 per cent. A new Series H bond, paying current interest at an average rate of 3 per cent, is to be put on the market in June. The limit on Series E bond purchases, formerly $10,000 a year, is being replaced by a limit of $20,000 maturity value. Series H is also given a $20,000 limit. Purchases of both series are restricted to individuals.

Series F and G bonds, 12-year bonds paying 2½ per cent, are being replaced by new Series J and K bonds of the same term but paying 2¾ per cent. The new Series J and K are given a combined limit of $200,000 purchase value against the old limit of $100,000 on F and G.

In announcing these changes, Secretary of the Treasury Snyder stated that their purpose was "to keep up with the times." They represent a concession to the saver's demands for a better rate on his money and should make a positive contribution toward financing the deficit and maintaining a wide ownership of the public debt. The next logical step in the Treasury's borrowing program is to offer long-term bonds designed to tap institutional savings. It would be a pity if the present opportunity were allowed to go by.

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